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FM AMEMBASSY LIMA  
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INFO RUEHBO/AMEMBASSY BOGOTA 3892  
RUEHBU/AMEMBASSY BUENOS AIRES 2575  
RUEHCV/AMEMBASSY CARACAS 9775  
RUEHQT/AMEMBASSY QUITO 0678  
RUEHLP/AMEMBASSY LA PAZ SEP SANTIAGO 0842  
RUCPDO/DEPT OF COMMERCE WASHINGTON DC  
RUEATRS/DEPT OF TREASURY WASHINGTON DC  
RUEHC/DEPT OF INTERIOR WASHINGTON DC  
RHEFDIA/DIA WASHDC  
RHMFIUU/CDR USSOUTHCOM MIAMI FL  
RUEAIIA/CIA WASHINGTON DC  
RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC

UNCLAS LIMA 003662

SIPDIS

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SENSITIVE

DEPT FOR WHA/AND, WHA/EPSC, EB/OMA, EB/TPP  
COMMERCE FOR 4331/MAC/WH/MCAMERON  
USTR FOR BHARMAN AND MCARRILLO  
DEPT PASS TO INT/USGS/RESTON FOR DMENZIE/AGURMENDI  
DEPT PASS TO OPIC FOR J BRACHE  
DEPT PASS TO EXIM FOR DON HULTMAN

E.O. 12958: N/A

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SUBJECT: MINING COMPANIES TO MAKE "VOLUNTARY" SOCIAL CONTRIBUTION

1. (U) Summary: To fend off political pressure, including the specter of a windfall tax, mining companies operating in Peru agreed to make a "voluntary" contribution of up to \$773 million over the next five years. The solution, in which Prime Minister Jorge del Castillo played a key role, was seen as an effective way of increasing funds for much-needed poverty alleviation without "changing the rules" on investors in a vital sector. The deal is off if taxes increase or world metal prices drop below a reference level. The firms, which include a number of U.S.-owned companies, will control the funds, to be used for community development projects, but will coordinate the involved communities and receive "guidance" from the GOP. Public dissatisfaction over lack of access to the mining royalties reserved for communities had led to mounting political pressure for a legislated solution such as a windfall profits tax. Already Peru's largest taxpayers, most U.S. mining firms already have extensive community projects in place. The extra development funds will support President Garcia's "Investment Shock", aimed at creating immediate jobs and alleviating poverty. End Summary.

#### CONTRIBUTION AGREEMENT

2. (U) On August 24, 2006, Prime Minister Jorge Del Castillo announced to the Peruvian Congress that the mining companies operating in Peru were going to make a collective contribution totaling 2.5 billion soles (\$773 million) to be used for community development. The contribution will be divided among all firms and paid in five parts from 2006 to 2010. Del Castillo stressed that this contribution was in addition to what the mining companies were already spending to assist community projects.

3. (U) The deal, del Castillo explained to Congress, respects the rule of law while giving the GOP immediate funds to fight poverty, malnutrition and social exclusion in mining zones, some of Peru's poorest areas. (Note: Areas that voted for Ollanta Humala and may do so again in November, unless the government is seen as addressing their needs. End Note) The voluntary contributions are in addition

to the \$10 billion that mining companies plan to invest in new projects in the next five years, which del Castillo admitted, in his address to Congress, will provide thousands of new jobs and generate indirect social benefits.

#### DETAILS

14. (U) Mining companies will not pay the voluntary contributions to SUNAT (the tax agency) but will manage them as company-specific private funds. The GOP will not be involved in executing projects and will only offer "guidance." The companies, communities, and local governments will jointly determine where, on what and when the monies are spent. This process would avoid the long delays that local governments have experienced in accessing the growing "Canon" royalty funds. Corporate management will "unblock" needed public works since the firms have the qualified engineering and management staff that the local governments do not, and the firms need not be hindered by bureaucratic regulations that slow public projects. (Note: the Mining Canon comprises half of firms' income taxes, reserved for local development. The dramatic delay in canon funds actually disbursed for projects has been due in part to the inability of municipal governments to prepare suitable project proposals, and in part to what appear to have been holdups in the Finance Ministry's screening system (SNIP). End Note)

#### ROYALTY PAYMENTS CAN BE DEDUCTED FROM CONTRIBUTION

15. (U) The deal was negotiated directly with the main industry trade organization, the Peruvian Society of Mining, Petroleum and Energy (SNMPE). While the deal has yet to be formalized by lawyers, we understand the agreed contribution will be three percent of each mining company's pre-tax profits. All companies will pay this contribution, regardless of any previous tax stability contract. SNMPE Vice-President (and also CEO of Peru's largest mine, Southern Peru Copper), Oscar Gonzalez Rocha clarified that companies that currently pay mining royalties will deduct these from the contribution that they may be assessed. (Note: mining royalties are taxes created in 2004, and started as a compensatory fee for use of Peru's resources. The Constitutional Court upheld firms' challenge to the law in a controversial 2005 ruling. End note.)

16. (U) Mining companies obtained the GOP's acceptance to several important conditions for these extraordinary contributions: the deal is off should current tax rates increase, new taxes be passed, or world metal prices decrease below a reference level. The GOP is currently working out with the companies the formula to be used for calculating each firm's baseline for the contribution, as well as the final amount that each firm will contribute.

#### FIT WITH GARCIA'S INVESTMENT SHOCK

17. (U) GOP officials, from President Garcia down, expressed public satisfaction at the results of the negotiations and say the extra money will be a shot in the arm for the GOP's well-publicized "Investment Shock," designed to jump-start local economies. The plan is to carry out projects as promptly as possible in impoverished regions to create jobs and alleviate poverty. The mine firms agreed that one-third of the first year's contribution could cover collective compensations the GOP would pay to victims of human rights abuses that occurred in the 1980s and 1990s during the conflict with the Shining Path and MRTA guerilla groups.

#### BACKGROUND TO THE DEAL

18. (SBU) The idea of a voluntary contribution actually arose within the mining community as a means of forestalling growing political pressure to void tax stability agreements. Nonetheless, some mining firms resisted the idea of voluntary contributions for months. Mining companies are already Peru's main taxpayers; moreover, the new voluntary contributions are not tax deductible. The industry pays a 30 percent income tax -- estimated to reach \$1.85 billion in 2006 -- plus a variety of other taxes. While some of the Peruvian mining firms have done little in the way of community projects, most, if not all of the foreign firms have funded extensive community projects, including U.S.-owned companies.

19. (SBU) Realists within SNMPE understood that during the recent

presidential election campaigns, two of the three main contenders (APRA's Alan Garcia and UPP's Ollanta Humala) called for a windfall profits tax and a revision or even abrogation of the tax stability contracts held by most of the foreign firms that had acquired mines during the 1990's privatization campaign. Even after new President Garcia pledged to encourage foreign investment, many Peruvian congressmen expressed a preference for some sort of increased taxes.

Del Castillo appeared keen on reaching a compromise without "changing the rules", wanting to deliver something to Congress to avoid a call for legislation. (Note: One of President Toledo's last acts in office was to veto a law that would have imposed royalties on firms with tax stability agreements. End Note.) Del Castillo's planned presentation to Congress was delayed several times as negotiations continued.

110. (SBU) Producing a deal that involved all mining companies was an ambitious undertaking. On the basic question of whether to give any voluntary contributions, the smaller companies argued that they could not contribute extra when world metal prices go down. Most firms realize that once the public gets used projects facilitated by the voluntary contributions, it will be very hard to stop the contributions during lean years of low mineral prices. Internal negotiations on the size of contributions were complex and took several weeks due to the wide variations in: operation size; reserves size; type of operation or metal/s produced; and cost structure and legal situation (some with tax or juridical stability contracts, for some or all of their projects).

#### COMMENT

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111. (SBU) Mining companies have learned some bitter lessons over the past several years. Some mining contacts acknowledged they did not do enough for local communities; others lament that they did not publicize well enough the good works that they were doing. Some firms, such as U.S. Phelps Dodge, have recently reached deals to support local community projects. Others, such as U.S. Newmont's operation of Yanacocha, have also supported local projects for years but face determined opposition from Peruvian and international forces that are anti-mining and anti-foreign investment. The voluntary contributions and company-managed local projects hold out the opportunity for foreign investment and poverty alleviation to work - to continue working - hand in hand. Calculating and managing the contributions for so many diverse firms will be daunting, but well worth it if the collective will of the miners, the communities and the GOP can pull it off. Prime Minister del Castillo has shown political skill once again in resolving a thorny issue; our only concern is that he will simply not have the time to intervene personally to resolve every complaint by a local community against a mining company.

#### STRUBLE